No. 7128

In the United States Circuit Court of Appeals

For the Ninth Circuit.

Erle P. Halliburton,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent,
and
Vida C. Halliburton,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.

Application for Permission to File Reply to Petition for Rehearing and Memorandum in Opposition to Petition for Rehearing.

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APPLICATION FOR PERMISSION TO FILE REPLY TO PETITION FOR REHEARING

Petitioners respectfully request this Honorable Court to accept the attached memorandum in reply to Respondent's petition for rehearing.

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MEMORANDUM IN OPPOSITION TO PETITION FOR REHEARING.

The Respondent in his petition for rehearing urges that this Honorable Court reverse its decision for the reason that the Government's construction of the statute has the force and effect of law since Congress has re-enacted the provision under consideration. At the outset Petitioner recognizes the general rule of law that a regulation of the Department, which has been long and consistently followed over a period in which there have been repeated re-enactments of the statute, should be given great weight by the courts. However, we respectfully urge that the

construction placed by the Department on a statute does not have the force and effect of a regulation issued by the Treasury Department.

On page 10 of Respondent's brief he states that:

> "Early in 1928, the Treasury Department construed the word 'property', as used in Section 203 (b) (4), to mean property other than money."

The Respondent then cites G. C. M. 2062 VII-I Cumulative Bulletin 161, 163, being a memorandum by the General Counsel's office which is the legal advisor to the Commissioner of Internal Revenue. This G. C. M. has been incorrectly cited by Respondent, the correct citation being G. C. M. 2862. The Respondent does not quote the entire G. C. M. For the Court's benefit the complete General Counsel's memorandum is set forth as follows:

> "Revenue Act of 1924.
>
> "The word 'property' as used in section 203 (b) 4 of the Revenue Act of 1924 means property other than money. The payment of cash for stock is a purchase, not an exchange.
>
> "An opinion is requested as to whether taxable gain was realized by the members of the M partnership through the transfer of the assets of the partnership to the N Company, a corporation.
>
> "The facts are stated as follows:
>
> "It appears that on or about June 20, 1924, A and B, partners in the O Company, as parties of the first part, entered into a contract with six ..... companies, parties of the second part, namely, the P Company, the Q Company, the R Company, the S Company, the T Company, and the U Company, whereby it was agreed that a corporation known as

the N Company should be organized as of July 1, 1924, under the laws of the State of V, with an authorized capital stock of 5x dollars divided into 140y shares. The parties of the first part were to subscribe to 71.2y shares of stock, and this stock was to be paid for by the transfer to the corporation of the assets of the partnership, which were set forth in detail in the contract. Of this stock, 54.4y shares were to be issued directly to the taxpayers and 16.8y shares were to be issued to the W Bank as trustee for A. The latter shares were to have no voting power until certain treasury stock was sold. The parties of the second part were to purchase 52y shares of stock for cash of 2x dollars. The remaining 16.8y shares of stock represented treasury stock, which could later be sold at not less than par upon the approval of the board of directors.

"Under date of July 1, 1924, the corporation known as the N Company was incorporated, and A was made president and general manager, in accordance with the agreement previously entered into. The business was operated by A and B under the corporation's name, beginning July 1, 1924, and the corporation came into possession of the assets of the predecessor partnership on that date. It was not until July 23, 1924, that formal transfer and delivery of the assets occurred, and on that date stock in the amount of 2x dollars was issued to the six companies, parties of the second part, upon payment by them on that date of cash in the amount of 2x dollars. The delay in the formal transfer of the assets and the payment for and issuance of stock was apparently caused by certain litigation which was settled between July 1 and July 23, 1924. It also appears that the 71.2y shares of stock representing the consideration

for the transfer of the partnership assets were issued on or about the same date.

"Section 203 of the Revenue Act of 1924 provides in part as follows:

(a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) (4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

" 'Control' is defined under section 203(i) as meaning ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

"In the appeal of Louis Abrams (3 B. T. A. 385), the taxpayer was a member of a partnership consisting of himself and another. His share of the partnership assets was appraised at $30,000. The partnership transferred its assets to a corporation, and the taxpayer received stock therein of the par value of $30,000 for his interest. Others purchased for cash a substantial proportion of the stock. The taxpayer and his partner did not receive a sufficient percentage of the stock to give them control within the meaning of the 1921 Act. The cost of the assets

to the taxpayer was $19,778.47. The Commissioner ruled that the taxpayer received an equivalent of cash to the extent of $30,000 for his interest in the partnership, which the Commissioner determined cost him $19,778.47, making a difference of $10,221.53, representing taxable profit from the transaction. The Commissioner's determination was sustained.

"The decision in the Abrams case was rendered under the provisions of section 202(c) 3 of the Revenue Act of 1921, the import of which is substantially the same as section 203(b) 4 of the Revenue Act of 1924. The principle involved in that case is identical with that involved in the case presented. The language of the governing provision applies to the time 'immediately after the exchange.' In the instant case the contract to exchange the partnership assets for stock was dated June 20, 1924, and provided for exchange as of July 1, 1924. The exchange, however, was delayed until July 23, 1924, and 'immediately after the exchange' A and B did not have ownership of at least 80 per centum of the stock.

"Under section 203(a) gain or loss is recognized in every sale or exchange, unless within one of the exceptions enumerated in the other subdivisions of the section. The taxpayers contend that they come within the exception contained in section 203(b) 4 and that the cash paid for stock by the six companies is property within the meaning of the exception. It is the opinion of this office that the word 'property' as used in section 203(b) 4 means property other than money. This subdivision refers to an 'exchange' in four instances. The word 'purchase' is not used. The payment of cash for stock is a purchase, not an exchange. The language must be construed accord-

ing to its commonly accepted meaning. This position is supported by the manner in which the word 'exchange' is used throughout the Act, and also by the manner in which references are made to 'property' as distinguished from 'money' in the provisions with reference to exchanges, particularly in section 203(d), (e), and (f). To sustain the taxpayer's contention would necessitate placing a strained construction upon the language used.

"It is, therefore, the opinion of this office, supported by the decision in the Abrams case, *supra,* that the entire amount of the gain or loss to the taxpayers must be recognized in the manner provided for in section 203(a).

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue."

G. C. M. 2862 is a memorandum opinion written by the General Counsel's office on the very issues involved in the case at bar which is self-evident from a comparison of the facts. The question presented in the appeal before this Honorable Court in 1928 was submitted to the General Counsel's office with the result that he wrote the opinion referred to by the Respondent.

It is a general rule of law that acquiescence by the Commissioner of Internal Revenue and/or the Secretary of the Treasury of Bureau rulings without formal written approval cannot be treated as a regulation. This question was presented to the Court of Claims in the case of *Bedford Mills, Inc., v. U. S.,* No. K-92, 2 Fed. Supp. 769, and the court in that case on March 13, 1933, stated:

"G. C. M. 9401, *supra,* was not a regulation by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury as required

by the statute, and, notwithstanding the respect which we entertain for the opinions of the General Counsel of the Bureau of Internal Revenue, the court cannot give to Memorandum 9401 the force and effect of a regulation under the statute.

"It is stated in plaintiff's brief in support of its second motion for a new trial that Memorandum 9401 of the General Counsel had the approval of the Commissioner of Internal Revenue and the Undersecretary of the Treasury, but there is no evidence of this, and the said ruling, as officially published, bears no evidence of such approval as is required by the statute with respect to regulations authorized thereby. The acquiescence by the Commissioner and the Undersecretary of the Treasury of bureau rulings in a particular case without formal written approval thereof and publication as a regulation cannot be treated by the court as a regulation deliberately considered and made by the Commissioner with the approval of the Secretary of the Treasury under the statute. * * *"

Consequently, an opinion of the General Counsel does not have the weight of a regulation issued by the Commissioner with the approval of the Secretary of the Treasury. If the General Counsel's Opinion 2862 should have the force and effect of law, it would simply mean that the courts could not properly review the Government's action. The Commissioner of Internal Revenue on January 25, 1928, mailed his deficiency letters to Petitioners and the issues have been in controversy ever since that time. Certainly there has not been an acquiescence by these Petitioners or by the public in the General Counsel's ruling. His memorandum is merely his opinion and does not have the weight that a regulation of long standing has.

The Supreme Court of the United States has held that such departmental construction cannot be given the force and effect of law. In the case of *Georgine Iselin, Appellant, v. United States,* 270 U. S. 245-251, the Supreme Court stated:

> "The government calls attention to the fact that, as early as October 24, 1919, the Commissioner of Internal Revenue made the ruling pursuant to which the tax here in question was assessed; that on March 22, 1920, the Attorney General sustained that ruling; that the provisions here in question were re-enacted without substantial change in the Revenue Act of 1921, Act of November 23, 1921, Par. 800(a), chap. 136, 42 Stat. at L. 227, Comp. Stat. Par. 6309⅝a, Fed. Stat. Anno. Supp. 1921, p. 190, and the Revenue Act of 1924, Act of June 2, 1924, Par. 500(a), chap. 234, 43 Stat. at L. 253, Fed. Stat. Anno. Supp. 1924, p. 149; and that the administrative practice adopted in 1919 has been steadfastly pursued. It suggests that these facts imply legislative recognition and approval of the executive construction of the statute. But the construction was neither uniform, general, nor long continued; neither is the statute ambiguous. Such departmental construction cannot be given the force and effect of law. Compare United States v. Falk, 204 U. S. 143, 51 L. Ed. 411, 27 Sup. Ct. Rep. 191; National Lead Co. v. United States, 252 U. S. 140, 146, 64 L. Ed. 496, 499, 40 Sup. Ct. Rep. 237."

The argument of counsel for the Respondent that Section 203(b) (4) of the Revenue Act of 1924 did not apply to the transaction in question is, it is most respect-

fully submitted, beside the point. No doubt his position would be good in any case in which a person or a group of persons paid cash for stock. However, the argument completely overlooks the fact that a group transferred cash and other property. This is the distinction which this Honorable Court in its opinion recognized and which the Respondent ignores.

The Commissioner of Internal Revenue heretofore has consistently taken the position that the transfer of properties by Petitioners and the transfer of cash by the six oil companies should be considered a single transaction. This Honorable Court has agreed with this contention. Now, however, counsel for the Respondent would have this Court separate the two transactions and at the same time deny Petitioners the right to the benefits of the section. This Honorable Court, in determining Petitioner's tax liabilities, quite rightly viewed the group as a whole and it is believed that the Respondent's present contention is entirely without merit unless, of course, the Respondent is willing to concede that Mr. and Mrs. Halliburton, immediately after the transfer of their properties on July 1, 1924, were the owners of at least 80% of the then issued capital stock.

The Respondent urges, in his argument under Point III of his brief, that the Court erred in holding that a gain or loss can be realized on the purchase of corporate stock. Here again Respondent fails to make the distinction between the purchase of stock for cash solely and the trans-

fer of cash and other property by a group in exchange for stock of the corporation. Petitioner submits that the Court's opinion cannot be construed as holding that gain or loss can be realized on the purchase of corporate stock; that it simply stands for the proposition that where a group of persons transfers cash and other property for stock the cash is property within the meaning of the term as provided in Section 203(b) (4) of the Revenue Act of 1924.

In view of the foregoing it is respectfully submitted that Respondent's petition for rehearing should be denied.

Respectfully submitted,

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